

No. 83-1149

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**In the Supreme Court of the United States**  
**OCTOBER TERM, 1990**

**COY R. GOGAN, ET AL., PETITIONERS,**

**v.**

**FRANK J. GARNER, JR., RESPONDENT.**

**ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE EIGHTH CIRCUIT**

**BRIEF FOR THE RESPONDENT**

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## QUESTION PRESENTED

1. What burden of proof applies to the exception from discharge under Section 523(a)(2) of the Bankruptcy Code for debts arising from "false pretenses, a false representation, or actual fraud": preponderance of the evidence or clear and convincing evidence?

### I. THE CLEAR AND CONVINCING EVIDENCE STANDARD OF PROOF APPLIES IN ACTIONS UNDER SECTION 523(a)(2) OF THE BANKRUPTCY CODE TO EXCEPT FROM DISCHARGE DEBTS INCURRED BY FRAUD

#### A. The Clear and Convincing Evidence Standard Generally Applies to Cases Alleging Civil Fraud

#### B. The "Fresh Start" Doctrine Compels Application of the Clear and Convincing Evidence Standard in Section 523(a)(2) Proceedings

#### C. Interpretation of Other Provisions of the Bankruptcy Code is Consistent With Application of the Clear and Convincing Standard in Section 523(a)(2) Proceedings

#### A PRIOR CIVIL JUDGMENT OF FRAUD BASED UPON A PREPONDERANCE STANDARD OF PROOF DOES NOT COLLATERALLY ESTOP LITIGATION IN FRAUD ISSUES IN A SECTION 523(a)(2) PROCEEDING

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ON WRIT OF CERTIORARI TO THE UNITED STATES  
COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

STATEMENT OF THE CASE

On May 5, 1965, the United States District Court for the Western District of Missouri entered judgment on a jury verdict in favor of Petitioner, Coy R. Grogan and John H. Grogan, and against Respondent, Frank J. Grogan, Jr., an officer of Columbia Gas Transmission Corporation, for damages under the Securities Exchange Act of 1934, 15 U.S.C. § 78j. The jury awarded Respondent \$249,000 actual damages, and to the Grogans \$14,900 punitive damages. The United States Court of Appeals affirmed the judgment but reduced the amount of damages. *Appellate to Petition for Writ of Certiorari* ("App. Pet.") 34.

A general motion of reconsideration was filed on the record on appeal from the bankruptcy court, but the United States District Court "denied" it. The court stated that the burden of proof in this case was on the respondent. The trial court also instructed the jury that damages could be

# In the Supreme Court of the United States

OCTOBER TERM, 1990

No. 89-1149

COY R. GROGAN, et al., *Petitioners*,

v.

FRANK J. GARNER, JR., *Respondent*.

## ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

### BRIEF FOR THE RESPONDENT

#### STATEMENT OF THE CASE

On May 8, 1985, the United States District Court for the Western District of Missouri entered judgment on a jury verdict in favor of Petitioners, Coy R. Grogan and John H. Henson, and against Respondent, Frank J. Garner, Jr., on claims of common law fraud, breach of fiduciary duty and violation of the Securities Exchange Act of 1934. J.A. 28-31. The jury awarded Petitioners \$249,000 actual damages, and on the common law fraud claim, \$24,900 punitive damages. The United States Court of Appeals affirmed the judgment but reduced the amount of damages. Appendix To Petition For Writ of Certiorari ("App. Pet.") 3a.

A general burden of proof instruction was not in the record on appeal from the bankruptcy court, but the United States District Court "assume[d] . . . that the standard [Missouri] burden of proof instruction was used. . . ." App. Pet. 23a-24a. The trial court also instructed the jury that damages could not

be based on speculation; Petitioners had the burden of proving their damages by a "preponderance of the evidence." J.A. 46-47, 58.

On October 21, 1985, Respondent filed a petition for relief under Chapter 11 of the Bankruptcy Code, listing Petitioners' judgment as a dischargeable debt. Petitioners thereafter filed an adversary proceeding under 11 U.S.C. § 523(a) to except the debt from discharge. App. Pet. 3a-4a, J.A. 3-4. At the hearing on their Complaint, Petitioners called no witnesses. Instead, they offered in evidence four exhibits: (1) Petitioners' First Amended Complaint from the prior civil action, (2) an Addendum from the Brief of Appellant Garner to the United States Court of Appeals for the Eighth Circuit which included copies of the prior judgments, post-trial orders and various jury instructions, (3) the opinion of the Eighth Circuit affirming the judgment, and (4) a letter from the clerk of the court transmitting the Eighth Circuit's opinion. J.A. 7-10, 16-87. Petitioners did not offer a transcript of the prior fraud trial. Nor was there any stipulation by the parties that the witnesses in the prior trial, if called in the bankruptcy proceeding, would testify as they had previously. App. Pet. 31a.

Respondent moved for a directed verdict, arguing that Petitioners must prove the nondischargeability of a debt under section 523(a)(2) by clear and convincing evidence, not a mere preponderance. Accordingly, Respondent urged, the judgment from the prior fraud trial did not have collateral estoppel effect on the issue of whether the debt was dischargeable in bankruptcy, because of the differing burdens of proof. The court denied Respondent's motion. J.A. 10-12. Respondent then testified briefly, denying he ever had made any false statements or misrepresentations to Petitioners. J.A. 12-14.

The bankruptcy court concluded that collateral estoppel applied and that Petitioners had sustained their burden of establishing that the debt was not dischargeable under section 523(a)(2) of the Bankruptcy Code. App. Pet. 30a-41a. In denying Respondent's motion to alter or amend the judgment, the bankruptcy court declared that the "clear and convincing" stan-

dard was not a higher standard of proof than "preponderance of the evidence". J.A. 88-89.

The United States District Court for the Western District of Missouri affirmed the bankruptcy court's order. App. Pet. 16a-29a. Thereafter, the United States Court of Appeals for the Eighth Circuit reversed, holding that the bankruptcy court had erred in giving collateral estoppel effect to the prior fraud judgment because the jury verdict in that case was based on a preponderance of the evidence, whereas fraud under section 523 of the Bankruptcy Code must be established by clear and convincing evidence. App. Pet. 1a-15a.

## SUMMARY OF ARGUMENT

A claim that a debt arises from "false pretenses, a false representation, or actual fraud," and thus is excepted from discharge under section 523(a)(2) of the Bankruptcy Code, must be proved by clear and convincing evidence. When Congress enacted the Bankruptcy Reform Act of 1978, it did not prescribe what standard of proof should apply to determine whether a claim is excepted from discharge. However, when the statute was enacted, as today, the clear majority of states required proof of civil fraud by clear and convincing evidence.

The preponderance of the evidence standard applies in actions seeking merely a money judgment. Fraud cases require a higher standard of proof because of the strong presumption against fraud and bad faith, and to guard against possible fabrication of claims. Contrary to the suggestion of Petitioners and amici, the clear and convincing evidence standard is not limited to actions to reform written instruments or cases involving due process rights. This Court and most others have recognized that fraud must be proved by clear and convincing evidence. In fact, most courts, as well as the leading treatises on the subject, treat this proposition as a virtual truism.

The courts almost universally have applied the clear and convincing standard to actions under section 523(a)(2) of the Bankruptcy Code. In fact, every United States Court of Appeals that has addressed the issue has held that fraud must be proved by clear and convincing evidence before a debt will be excepted from discharge under section 523(a)(2). There is no split of authority on this issue. The circuit courts base their holdings on several factors, including the necessity to overcome the presumption of innocence, the authority of leading bankruptcy treatises, and most importantly, that the exceptions to discharge set forth in section 523(a) must be strictly construed to effectuate the fresh start policy which permeates the Bankruptcy Code and its legislative history.

Petitioners and amici sound an alarm at the prospect of differing standards of proof for different types of non-dischargeable debts under section 523(a). However, these differences always have existed, and they were prevalent when the Code was adopted. In fact, legislative history reveals that Congress was keenly aware that it was grouping various types of potentially non-dischargeable debts under the section 523 umbrella.

Amici also bemoan the unfair burden on the government if it must prove fraud by clear and convincing evidence in section 523(a)(2) discharge proceedings. However, when Congress passed certain anti-fraud statutes imposing on the government only the preponderance standard, Congress must be presumed to have known the alleged inconsistency it was creating. Whatever burden exists was created by Congress; it is not a new concept foisted upon the government by the court of appeals in this case. If the clear and convincing standard imposes too great a burden on the government, the solution is plain and simple: the government can persuade Congress to amend the Bankruptcy Code to specify the preponderance standard, as it has in other federal statutes.

Applying the clear and convincing standard in section 523(a)(2) proceedings also is consistent with judicial interpretations of other Bankruptcy Code provisions that require findings of fraud. Specifically, the courts universally require clear and convincing evidence to establish fraudulent transfers under 11 U.S.C. § 548(a)(1) and to justify the appointment of a trustee in Chapter 11 cases under 11 U.S.C. § 1104.

Applying the clear and convincing standard is not inconsistent with section 727(a)(4) or its legislative history. Courts have rejected the sketchy legislative history of section 727(a)(4) which amici suggest requires application of the preponderance standard under that section and, by analogy, section 523(a)(2). Congress' effort to define "bankruptcy crimes" under section 727 apparently has led to some confusion. However, it is clear that Congress was attempting merely to clarify that bankruptcy crimes need not be proved "beyond a reasonable doubt."

Amici's reading of the legislative history also is inconsistent with the Advisory Committee Notes which state that Bankruptcy Rule 4005 leaves to the courts the evidentiary standard that an objecting creditor must meet in dischargeability proceedings. Finally, the grounds for a complete denial of discharge under section 727 generally involve misconduct or fraud upon all creditors, or upon the court itself, within the confines of the bankruptcy proceeding. Congress may well have intended to prescribe a lower standard of proof under section 727(a)(4) than under section 523(a)(2) because the latter involves fraud with respect to the creation of a debt vis-a-vis one creditor only; it does not involve fraud upon the court or the bankruptcy process.

Application of the clear and convincing standard is consistent with the touchstone of the bankruptcy process: the fresh start policy. Since passage of the 1898 National Bankruptcy Act, this Court and others have noted that one of the primary purposes of the bankruptcy laws is to release the debtor from the burden of certain financial obligations so he or she may have a new economic start in life. Congress enacted the 1970 amendments for the specific purpose of effectuating more fully the discharge in bankruptcy. The legislative history of the Bankruptcy Reform Act of 1978 is laced with evidence that the fresh start policy was carried forward as a centerpiece of the new Bankruptcy Code. As this Court has noted, provisions of the Code are to be construed in harmony with the fresh start policy to effectuate the general purposes of the bankruptcy laws.

This Court has held that collateral estoppel, in the absence of a countervailing statutory policy, may bar relitigation of certain factual issues in bankruptcy courts. The all-encompassing policy of the fresh start is just such a countervailing statutory policy. If collateral estoppel applies at all in section 523(a) proceedings, then appropriate limitations must be prescribed to protect and perpetuate the fresh start policy.

Collateral estoppel does not apply in any event, however, if there are differing burdens of proof. Because the prior civil judgment in this case was based upon a mere preponderance of the evidence, that judgment, and any findings of fact in that

case, can have no collateral estoppel effect in the discharge proceeding.

The promotion of judicial economy by preventing needless litigation certainly is a laudable goal. While appealing on its face, this concept does not trump all other rights and interests. As urged by Petitioners and amici, the interest of judicial economy is inconsistent with the fresh start policy of the Bankruptcy Code. Respondent does not quarrel with the familiar adage that discharge is a privilege granted to the "honest but unfortunate debtor". However, before a debtor is branded as *both* dishonest and unfortunate, and denied a "fresh start in life," creditors should be required to establish fraudulent conduct by clear and convincing evidence. Accordingly, Respondent asks this Court to affirm the judgment of the Court of Appeals.

## ARGUMENT

### I. THE CLEAR AND CONVINCING EVIDENCE STANDARD OF PROOF APPLIES IN ACTIONS UNDER SECTION 523(a)(2) OF THE BANKRUPTCY CODE TO EXCEPT FROM DISCHARGE DEBTS INCURRED BY FRAUD

#### A. The Clear and Convincing Evidence Standard Generally Applies in Cases Alleging Civil Fraud

"Where Congress has not prescribed the appropriate standard of proof and the Constitution does not dictate a particular standard, [the Court] must prescribe one." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389 (1983). There are three basic standards of proof: (1) mere preponderance, (2) clear and convincing, and (3) beyond a reasonable doubt.<sup>1</sup> These standards occupy their respective places along a continuum of increasing certainty. *Addington v. Texas*, 441 U.S. 418, 423-24 (1979). The first two are applied in civil cases, while the third is reserved exclusively for criminal cases. *Id.*

Courts apply the preponderance of the evidence standard in typical civil actions for money damages. This standard allocates the risk of error in judgment in roughly equal fashion between the parties. *Huddleston*, 459 U.S. at 390. In a civil suit between two private parties, society's interests are not at stake. In the public's view, it is no more serious for there to be an error in favor of one side than the other. *In re Winship*, 397 U.S. 358, 371 (1970) (Harlan, J., concurring).

<sup>1</sup> "The function of a standard of proof . . . is to 'instruct the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication.'" *Addington v. Texas*, 441 U.S. 418, 423 (1979) (quoting *In re Winship*, 397 U.S. 358, 370 (1970) (Harlan, J., concurring)); see also *Cruzan v. Director, Missouri Dep't of Health*, 58 U.S. L.W. 4916, 4921 (U.S. June 25, 1990) (No. 88-1503).

In a discharge proceeding under 11 U.S.C. § 523(a)(2), however, more is at stake than a mere money judgment. At stake is an adjudication of fraud, which traditionally must be established by *more* than a mere preponderance of the evidence.<sup>2</sup> Because proof of fraud under section 523(a)(2) would deny Respondent a discharge and override the fresh start policy of the Bankruptcy Code, Petitioners should be required to meet a higher evidentiary standard.

The clear and convincing standard originated in the courts of equity and was applied to claims that were "shown to be inherently subject to fabrication, lapse of memory, or the flexibility of conscience." Note, *Appellate Review in the Federal Courts of Findings Requiring More Than a Preponderance of the Evidence*, 60 Harv. L. Rev. 111, 112 (1946). Today, this "intermediate" standard "is no stranger to the civil law." *Woodby v. INS*, 385 U.S. 276, 285 (1966). "The [clear and convincing] standard, or an even higher one, has traditionally been imposed in cases involving allegations of civil fraud, and in a variety of other kinds of civil cases . . ." *Id.* at 285 n.18 (emphasis added) (citing 9 Wigmore, Evidence § 2498 (3d ed. 1940)).

<sup>2</sup> However, the burden of proof instruction given by the federal court in the prior civil action in this case appears to be Missouri Approved Instruction ("M.A.I.") No. 3.01. App. Pet. 23a-24a. The drafters of the M.A.I. intended for Instruction No. 3.01, the general burden of proof instruction, to be a jury-friendly way of requiring "preponderance of the evidence" or "the greater weight of the evidence." 1963 Report to Missouri Supreme Court, *Missouri Approved Instructions* (3d ed.).

See also *Cruzan v. Director, Missouri Dep't of Health*, 58 U.S.L.W. 4916, 4921 (U.S. June 25, 1990) (No. 88-1503).<sup>3</sup>

The clear and convincing standard is applied when there is more at stake than mere loss of money. *Santosky v. Kramer*, 455 U.S. 745, 756 (1982) (quoting *Addington*, 441 U.S. at 424). While this standard regularly has been applied in actions to reform or annul written instruments on the grounds of fraud, it is not limited to those types of cases.<sup>4</sup> Rather, the clear and convincing standard has been applied in many equity contexts. See generally 9 Wigmore, *Evidence* § 2498 (Chadbourn rev. 1981); 30 Am. Jur. 2d *Evidence* § 1167 (1967); 32A C.J.S.

<sup>3</sup> A leading treatise on the law of evidence concurs:

While . . . the traditional measure of persuasion in civil cases is by a preponderance of evidence, there is a limited range of claims and contentions which the party is required to establish by a more exacting measure of persuasion. The formula varies from state to state, but among the phrases used are the following: "By clear and convincing evidence," "clear, convincing and satisfactory," "clear, cogent and convincing," and "clear, unequivocal, satisfactory and convincing."

Among the classes of cases to which this special standard of persuasion has been applied are the following: (1) charges of fraud and undue influence, . . . (4) proceedings to set aside, reform or modify written transactions or official acts on grounds of fraud, mistake or incompleteness, and (5) miscellaneous types of claims and defenses . . . where there is thought to be special danger of deception . . .

E. Cleary, *McCormick On Evidence* § 340, at 959-61 (3d ed. 1984) (emphasis added) (footnotes omitted).

<sup>4</sup> Several courts state that the clear and convincing standard is applicable "especially" (but not exclusively) where the complaining party is moving to set aside a written instrument. See, e.g., *Weise v. Red Owl Stores*, 286 Minn. 199, 175 N.W.2d 184 (1970); *Gillingham v. Stadler*, 93 Idaho 874, 477 P.2d 497 (1970).

*Evidence* § 1253 (1964); Pomeroy, *Equity Jurisprudence* § 859a (1941).<sup>5</sup>

The Legislative Statements to 11 U.S.C. § 523(a)(2) recite that there is no indication of any Congressional intent to incorporate into section 523(a)(2) a definition of "fraud" other than that used at common law. Thus, the historical treatment of common law fraud claims is crucial to a determination of the appropriate burden of proof in this case. "Where the language of the statute is subject to reasonable doubt, reference to common law principles may provide a valuable clue . . . . Legislation must be interpreted in light of the common law and the scheme of jurisprudence existing at the time of its enactment." 2A Singer, *Sutherland Statutory Construction* § 50.01 (4th ed. 1984) (citing *Isbrandtsen Co. v. Johnson*, 343 U.S. 779 (1952)). See also *United States v. Sanges*, 144 U.S. 310 (1892). The Court presumes that Congress intended to maintain continuity between pre-Code judicial practice and the enactment of

<sup>5</sup> The clear and convincing standard has been required to prove charges of fraud or undue influence, *Barr Rubber Co. v. Sun Rubber Co.*, 425 F.2d 1114, 1120 (2d Cir. 1970); to prove the existence and contents of a lost deed or will, *Slaughter v. Cornie Slave Co.*, 291 S.W. 69, 71 (Ark. 1927); to prove a parole gift or agreement to bequeath or devise by will, *Estate of Passman*, 537 S.W.2d 380, 384 (Mo. 1976); to prove mutual mistake sufficient to reform a written instrument, *Philippine Sugar Estates Dev. Co. v. Philippine Islands*, 247 U.S. 385, 391 (1917); to prove a parole or constructive trust, *Harris v. Gurley*, 80 F.2d 744, 748 (5th Cir. 1936); to cancel a contract, *Atlantic Delaine Co. v. James*, 94 U.S. 207 (1876); to prove an oral contract as a basis for specific performance, *Boyers v. Boyers*, 147 S.W.2d 473 (Mo. 1941); and to show prior anticipatory use of an invention, *Haggerty v. Rawlings Mfg. Co.*, 14 F.2d 928, 929 (8th Cir. 1926). Treatises identify many other situations in which clear and convincing proof has been required, including: proof of a principal's ratification of the unauthorized act of an agent; showing a deed absolute on its face to be a mortgage; and to prove facts relied upon in support of estoppel. See 30 Am. Jur. 2d *Evidence* § 1167 (1967). The Court also has applied the clear and convincing standard to certain defamation actions. *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 331-32 (1974). The same standard applies where constitutional considerations of due process and individual rights are implicated. The Court thus has required clear and convincing evidence in the context of civil commitment proceedings, *Addington v. Texas*, 441 U.S. 418 (1979); deportation, *Woodby v. INS*, 385 U.S. 276 (1966); termination of parental rights, *Santosky v. Kramer*, 455 U.S. 745 (1982); and denaturalization, *Chaunt v. United States*, 364 U.S. 350 (1960).

the Bankruptcy Code in 1978, *Midatlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494, 501 (1986); and Congress is presumed to know the existing law at the time of the enactment of a statute. *Cannon v. University of Chicago*, 441 U.S. 677, 696-97 (1979); see also *Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 184-85 (1988); *Abernaz v. United States*, 450 U.S. 333, 341-42 (1981).

At the time of the enactment of the Bankruptcy Code in 1978, a significant majority of states required that fraud be proved by something more than a preponderance of the evidence, typically by clear and convincing evidence.<sup>6</sup> The same

<sup>6</sup> *Klinger v. Hummel*, 11 Ariz. App. 356, 464 P.2d 676 (1970); *Busker v. United Illuminating Co.*, 156 Conn. 456, 242 A.2d 708 (1968) ("clear, precise & unequivocal"); *Dobison v. Bank of Hawaii*, 60 Haw. 225, 587 P.2d 1234 (1978); *Gillingham v. Stadler*, 93 Idaho 874, 477 P.2d 497 (1970); *Ray v. Winter*, 67 Ill.2d 296, 367 N.E.2d 678 (1977); *Hall v. Wright*, 261 Iowa 758, 156 N.W.2d 661 (1968) ("preponderance that is clear, satisfactory and convincing"); *Sanford Constr. Co. v. S & H Contractors, Inc.*, 443 S.W.2d 227 (Ky. Ct. App. 1969); *Moore v. Moore*, 272 So.2d 407, 410 (La. Ct. App. 1973); *Iwanosky v. Iwany*, 319 A.2d 339 (Me. 1974) ("clear, strong, satisfactorily & constituted"); *Peurifoy v. Congressional Motors, Inc.*, 254 Md. 501, 255 A.2d 332 (1969); *Transitron Elec. Corp. v. Hughes Aircraft Co.*, 649 F.2d 871 (1st Cir. 1981) (applying Mass. law); *Hi-Way Motor Co. v. International Harvester, Co.*, 398 Mich. 330, 247 N.W.2d 813 (1976); *Weise v. Red Owl Stores, Inc.*, 286 Minn. 199, 175 N.W.2d 184 (1970); *Barrett v. Turner*, 229 So.2d 563 (Miss. 1969); *Page v. Andreasen*, 200 Neb. 641, 264 N.W.2d 682 (1978); *Lubbe v. Barbee*, 91 Nev. 596, 540 P.2d 115 (1975); *Hoyt v. Horst*, 105 N.H. 380, 201 A.2d 118 (1964); *Caledonia, Inc. v. Trainor*, 123 N.H. 116, 459 A.2d 613 (1983); *Blowit v. Dolitsky*, 124 N.J. Super. 101, 304 A.2d 774 (1973); *Rael v. Cisneros*, 82 N.M. 705, 487 P.2d 133 (1971); *Simcusi v. Saeli*, 44 N.Y.2d 442, 377 N.E. 713, 406 N.Y.S.2d 259 (1978); *Bahner v. Hoeven*, 228 N.W.2d 893 (N.D. 1975) ("clear & satisfactory"); *Daubert v. Mosley*, 487 P.2d 353 (Okla. 1971) ("clear & satisfactory"); *Bausch v. Myers*, 273 Or. 376, 541 P.2d 817 (1975); *Yoo Hoo Bottling Co. v. Leibowitz*, 432 Pa. 117, 247 A.2d 469 (1968); *Frankfurt v. Wilson*, 353 S.W.2d 490 (Tex. Civ. App. 1961) ("clear & satisfactory"); *Schwartz v. Tanner*, 576 P.2d 873 (Utah 1978); *Bardill Land & Lumber, Inc. v. Davis*, 135 Vt. 81, 370 A.2d 212 (1977) ("clear & satisfactory"); *Gibson v. Gibson*, 207 Va. 821, 153 S.E.2d 189 (1967); *Beckett v. Department of Social & Health Servs.*, 87 Wash.2d 184, 550 P.2d 529 (1976); *General Elec. Credit Corp. v. Fields*, 140 W.Va. 176, 133 S.E.2d 780 (1964) ("clear & distinct"); *Miles v. Mackle Bros.*, 73 Wis.2d 84, 242 N.W.2d 247 (1976); *Schaffer v. Standard Timber Co.*, 79 Wyo. 137, 331 P.2d 611 (1958); *Gilbert v. Mid-South Mach. Co.*, 267 S.C. 211, 227 S.E.2d 189 (1976); *Fox v. Wilson*, 211 Kan. 563, 507 P.2d 252 (1973) ("quality" of the evidence judged by clear and convincing, "quantity" judged by preponderance).

is true today.<sup>7</sup> A distinct minority of states appear to follow the preponderance standard exclusively.<sup>8</sup> Several states employ a

<sup>7</sup> *D.H. Dep't Store v. Feil*, 472 So.2d 1001 (Ala. 1985); *Rhoads v. Harvey Publications, Inc.*, 145 Ariz. 142, 700 P.2d 840 (1984); *Ficor, Inc. v. McHugh*, 639 P.2d 385 (Colo. 1982); *Miller v. Appleby*, 183 Conn. 51, 438 A.2d 811, 813 (1981) ("clear & satisfactory"); *Dobison v. Bank of Hawaii*, 60 Haw. 225, 587 P.2d 1234 (1978); *Magic Valley Potato Shippers v. Continental Ins.*, 112 Idaho 1073, 739 P.2d 372 (1987); *Hoffman v. Hoffman*, 94 Ill.2d 205, 446 N.E.2d 499 (1983); *Hall v. Wright*, 261 Iowa 758, 156 N.W.2d 661 (1968) (preponderance that is clear, satisfactory and convincing); *Fox v. Wilson*, 211 Kan. 563, 507 P.2d 252 (1973) ("quality" of the evidence judged by clear and convincing, "quantity" judged by preponderance); *Sanford Constr. Co. v. S & H Contractors, Inc.*, 443 S.W.2d 227 (Ky. Ct. App. 1969); *Butler v. Poulin*, 500 A.2d 257 (Me. 1985); *Peurifoy v. Congressional Motors, Inc.*, 254 Md. 501, 255 A.2d 332 (1969); *Transitron Elec. Corp. v. Hughes Aircraft Co.*, 649 F.2d 871 (1st Cir. 1981) (Mass. law); *Hi-Way Motor Co. v. International Harvester, Co.*, 398 Mich. 330, 247 N.W.2d 813 (1976); *Weise v. Red Owl Stores, Inc.*, 286 Minn. 199, 175 N.W.2d 184 (1970); *Barrett v. Turner*, 229 So.2d 563 (Miss. 1969); *Tobin v. Flynn & Larsen Implement Co.*, 220 Neb. 259, 369 N.W.2d 96 (1985) (clear and convincing in equity cases, preponderance at law); *Lubbe v. Barbee*, 91 Nev. 596, 540 P.2d 115 (1975); *Caledonia, Inc. v. Trainor*, 123 N.H. 116, 459 A.2d 613 (1983); *Stochastic Decisions, Inc. v. DiDomenico*, 236 N.J. Super. 388, 565 A.2d 1133 (N.J. Super. Ct. App. Div. 1989); *Simcusi v. Saeli*, 44 N.Y.2d 442, 377 N.E. 713, 406 N.Y.S.2d 259 (1978); *Norwest Bank Bismark v. Faiman*, 420 N.W.2d 357 (N.D. 1988) ("clear & satisfactory"); *Bausch v. Myers*, 273 Or. 376, 541 P.2d 817 (1975); *Yoo Hoo Bottling Co. v. Leibowitz*, 432 Pa. 117, 247 A.2d 469 (1968) ("clear & convincing"); *Rutledge v. St. Paul Fire & Marine Ins. Co.*, 286 S.C. 360, 334 S.E.2d 131 (1985); *Frankfurt v. Wilson*, 353 S.W.2d 490 (Tex. Civ. App. 1961) ("clear & satisfactory preponderance"); *Schwartz v. Tanner*, 576 P.2d 873 (Utah 1978); *Bardill Land & Lumber, Inc. v. Davis*, 135 Vt. 81, 370 A.2d 212 (1977) ("clear & satisfactory"); *Beckett v. Department of Social & Health Servs.*, 87 Wash.2d 184, 550 P.2d 529 (1976); *Tri-State Asphalt Prods. v. McDonough Co.*, 391 S.E.2d 907 (W.Va. 1990); *Miles v. Mackle Bros.*, 73 Wis.2d 84, 242 N.W.2d 247 (1976); *Duffy v. Brown*, 708 P.2d 433 (Wyo. 1985).

<sup>8</sup> *Saxon v. Harris*, 395 P.2d 71 (Alaska 1964); *Killion v. Hayes Bros. Lumber Co.*, 251 Ark. 121, 470 S.W.2d 939 (1971); *Liodas v. Sahad*, 137 Cal. Rptr. 635, 562 P.2d 316 (1977); *Kern v. NCD Indus., Inc.*, 316 A.2d 576 (Del. Ch. 1973); *Watson Realty Corp. v. Quinn*, 452 So.2d 568 (Fla. 1984); *O'Connell v. Supreme Conclave Knights*, 102 Ga. 143, 28 S.E. 282 (1897); *Baltimore, O. & C. R. Co. v. Scholes*, 14 Ind. App. 524, 43 N.E. 156 (1896); *Cowan v. Westland Realty Co.*, 162 Mont. 379, 512 P.2d 714 (1973); *Ostalkiewicz v. Guardian Alarm*, 520 A.2d 563 (R.I. 1987); *Jennings v. Jennings*, 309 N.W.2d 809 (S.D. 1981); *Calhoun v. Baylor*, 646 F.2d 1158 (6th Cir. 1981) (applying Tennessee law).

semantic hybrid of the two,<sup>9</sup> and some states apparently use both.<sup>10</sup> In several other states the standard depends upon the facts or circumstances of the particular fraud case.<sup>11</sup> One state genuinely has mixed the two standards.<sup>12</sup>

States advocating the clear and convincing standard offer various reasons for the higher standard: (1) to overcome the strong presumption against fraud or bad faith,<sup>13</sup> (2) to set aside written instruments because they have a higher presumption of

<sup>9</sup> See, e.g., *Hall v. Wright*, 261 Iowa 758, 156 N.W.2d 661 (1968) ("preponderance of the evidence that is clear and convincing").

<sup>10</sup> The Missouri Supreme Court has held that the standard of proof in fraudulent misrepresentation cases "should not be greater than in other cases tried to juries." *Crawford v. Smith*, 470 S.W.2d 529, 533 (Mo. 1971). *Crawford*, however, has been distinguished as applying only to cases at law. *In re Estate of Mitchell*, 610 S.W.2d 681 (Mo. App. 1980). Other Missouri courts have held that fraud must be proven by clear and convincing evidence. *South Side Nat'l Bank v. Winfield Fin. Servs. Corp.*, 783 S.W.2d 140 (Mo. App. 1989); *Center Bank v. Bliss*, 765 S.W.2d 276 (Mo. App. 1988); *Barrett v. Flynn*, 728 S.W.2d 288 (Mo. App. 1987).

<sup>11</sup> Ohio uses the preponderance standard in traditional civil fraud cases but applies the clear and convincing standard if the complaining party seeks to set aside a written instrument. *Household Fin. Corp. v. Altenberg*, 5 Oh. St. 2d 190, 214 N.E.2d 667 (1966). Nebraska holds that the preponderance standard applies to cases at law while the clear and convincing standard applies to cases in equity. *Tobin v. Flynn & Larsen Implement Co.*, 220 Neb. 259, 269 N.W.2d 96 (1985). North Carolina uses the preponderance standard in actions to set aside written instruments, but requires the clear and convincing standard in actions to reform a document. *Maynard v. Durham & S. Ry. Co.*, 112 S.E.2d 249 (N.C. 1960), *rev'd on other grounds*, 365 U.S. 160 (1961).

<sup>12</sup> In Kansas, courts apply the two standards to different elements of the evidence. The "preponderance" standard applies to the "quantum" or quantity of the evidence while the "clear and convincing" standard applies to the "character" or quality of the evidence. *Fox v. Wilson*, 211 Kan. 563, 507 P.2d 252, 265 (1973).

<sup>13</sup> See, e.g., *Barrett v. Turner*, 229 So.2d 563 (Miss. 1969) (proof must not only preponderate over the defendant's evidence but must overcome the strong presumption of innocence); *Sajich v. Sajich*, 129 Ill.App.2d 432, 262 N.E.2d 11, 14 (1970) (because of the presumption that all persons are innocent, the higher burden of proof is needed).

validity than oral evidence,<sup>14</sup> and (3) to guard against the potential damage to a party's reputation by fraud claims, which by their nature can be fabricated easily.<sup>15</sup>

On various occasions, this Court has held that fraud must be proved by clear and convincing evidence. See, e.g., *Addington v. Texas*, 441 U.S. 418, 424 (1979); *Lalone v. United States*, 164 U.S. 255 (1896); *United States v. American Bell Tel. Co.*, 167 U.S. 224 (1897) (citing *Colorado Coal & Iron Co. v. United States*, 123 U.S. 307 (1887)). In *Lalone*, the Court observed that "the rule is of long standing and is of universal application, that the evidence tending to prove . . . fraud . . . must be clear and satisfactory." *Lalone*, 164 U.S. at 257.

In requiring the higher standard in this case for section 523(a)(2) proceedings, the Eighth Circuit stated that it was following the majority rule. *In re Garner*, 881 F.2d 579, 581 (8th Cir. 1989). In doing so, the court properly presumed that Congress was aware that the prevailing view at the time of enactment of the Code was that fraud, for both section 523 and state common law purposes, had to be proved by clear and convincing evidence. *Id.* at 582. The court was following its earlier decision in *In re Van Horne*, 823 F.2d 1285 (8th Cir. 1987), namely that "[c]reditors bear the burden of proof . . . and must prove each element of their claim by clear and convincing evidence." *Id.* at 1287.

What the Eighth Circuit described as the majority rule is in fact the universal rule of the United States Courts of Appeals that have addressed the issue. There is no split among the circuits in the context of section 523(a)(2) proceedings. *Allstate Ins. Co. v. Foreman*, No. 89-4516, slip op. at 4 (5th Cir., July 2, 1990) (1990 W.L. 89467) ("Cognizant of the overarching policy in the Bankruptcy Code in favor of giving the debtor an

<sup>14</sup> See *supra* notes 4 and 5. See also *Maxwell Land-Grant Case*, 121 U.S. 325, 381 (1887).

<sup>15</sup> See, e.g., *Disner v. Westinghouse Elec. Corp.*, 726 F.2d 1106, 1110 (6th Cir. 1984) ("Courts have recognized, perhaps because the nature of the evidence in cases involving allegations of fraud is often circumstantial, that claims of fraud can be fabricated easily.").

opportunity for a fresh start, we endorse the application of the "clear and convincing" standard in the § 523(a)(2) dischargeability context"); *In re Gerlach*, 897 F.2d 1048, 1052 (10th Cir. 1990) ("A creditor seeking to have a debt declared non-dischargeable . . . must prove that it comes within the statute by clear and convincing evidence"); *In re Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986) ("The burden is on the creditor to prove the debtor's culpability [under section 523(a)(2)] by clear and convincing evidence"); cf. *Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1262 (11th Cir. 1988) ("There is no question but that the parties seeking to except a debt from discharge must prove the willfulness and maliciousness of the act [under section 523(a)(6)] by clear and convincing evidence"); *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986) ("A creditor seeking an exception from discharge under Section 523(a)(2) must sustain this burden by clear and convincing evidence"); *In re Black*, 787 F.2d 503, 505 (10th Cir. 1986) ("A creditor seeking to have a debt declared nondischargeable under [section 523(a)(2)(A)] must prove that it comes within the statute by clear and convincing evidence"); *In re Martin*, 761 F.2d 1163, 1165 (6th Cir. 1985) ("The party seeking an exception from discharge under section 523(a)(2) has the burden of proof by clear and convincing evidence"); *In re Kimzey*, 761 F.2d 421, 423-24 (7th Cir. 1985) ("The party objecting to discharge must prove the facts establishing each element [under section 523(a)(2)] by clear and convincing evidence"). See also *In re Braen*, 900 F.2d 621, 624-25 (3d Cir. 1990) (dicta declaring that clear and convincing evidence is universally required of creditors claiming fraud); *In re Dougherty*, 84 B.R. 653, 656 (Bankr. 9th Cir. 1988) (creditors must prove each of the elements of a dischargeability action by clear and convincing evidence); 3 L. King, R. Babitt, A. Herzog & R. Levin, *Collier on Bankruptcy*, § 523.08[5] (15th ed. 1990) ("At the time of the Code's enactment in 1978, courts were holding that for purposes of bringing a debt within Section 17a(2) of the Bankruptcy Act of 1898, the fraud had to be proved by clear and convincing evidence") (footnotes and citations omitted).

Petitioners cite *Combs v. Richardson*, 838 F.2d 112 (4th Cir. 1988), to suggest there is a split among the circuits regarding the burden of proof in section 523(a)(2) cases. However, the issue in *Combs* was whether a debt was nondischargeable in bankruptcy under section 523(a)(6), which deals with willful and malicious injury (assault), not under section 523(a)(2), which deals with fraud. The Fourth Circuit concluded that in light of the Code's silence regarding the standard of proof the courts "may not imply a higher standard than the preponderance standard normally applied in civil proceedings." *Id.* at 116. This holding is contrary to *Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1262 (11th Cir. 1988), which required proof by clear and convincing evidence under section 523(a)(6). While there is, then, a split among the circuits with respect to the burden of proof under section 523(a)(6), the circuit courts uniformly have required clear and convincing evidence to prove fraud under section 523(a)(2). *Combs* is distinguishable from the instant case because it dealt with a non-fraud question. Accord *In Re Pappas*, 107 B.R. 95, 99 n.3 (Bankr. W.D. Va. 1989) (citing *Oriel v. Russell*, 278 U.S. 358 (1929)). In *Oriel*, the Court held that a motion for a bankruptcy turnover order must be established by clear and convincing evidence. "It is a charge equivalent to one of fraud, and must be established by the same kind of evidence required in a case of fraud in a court of equity. A mere preponderance of evidence in such a case is not enough." *Oriel*, 278 U.S. at 362.

The Third Circuit recently followed *Combs* regarding the burden of proof in section 523(a)(6) cases, but specifically distinguished those "willful and malicious" cases from section 523(a)(2) "fraud" cases. *In re Braen*, 900 F.2d 621 (3d Cir. 1990). Although refusing to apply the clear and convincing standard to section 523(a)(6), the *Braen* court distinguished its decision from many others involving section 523(a)(2), including *In re Garner*, 881 F.2d 579. The Third Circuit stated that section 523(a)(2) cases involve claims of fraud, and "common law actions for fraud have historically employed the heavier clear and convincing evidence burden of proof." *In re Braen*,

900 F.2d at 625 & n.2 (citing *Lalone v. United States*, 164 U.S. 255, 257 (1896)). Moreover, the court noted that the clear and convincing standard is "universally required of creditors claiming fraud," and that "virtually all courts have adopted the clear and convincing standard in disputes under § 523(a)(2) . . . ." 900 F.2d at 625.

In universally requiring clear and convincing evidence in section 523(a)(2) cases, the courts of appeals have relied on several grounds, including (1) the necessity to overcome the presumption of innocence, *In re Black*, 787 F.2d at 505; *In re Hunter*, 780 F.2d at 1579; (2) the authority of the leading bankruptcy treatises, *In re Phillips*, 804 F.2d at 932; *In re Black*, 787 F.2d at 505; (3) the fresh start policy, *In re Van Horne*, 823 F.2d at 1287; *In re Garner*, 881 F.2d at 582; *Allstate Ins. Co.*, slip op. at 4 (1990 W.L. 89467); and (4) that exceptions to discharge under section 523(a) are to be strictly construed against the objecting creditor, *Allstate Ins. Co.*, slip op. at 4 (1990 W.L. 89467); *In re Van Horne*, 823 F.2d at 1287; *In re Gerlach*, 897 F.2d at 1052; *In re Black*, 787 F.2d at 505; and *In re Dougherty*, 84 B.R. at 656.

The overwhelming majority of the bankruptcy courts to address the issue have applied the clear and convincing standard in section 523(a)(2) fraud cases, many declaring that the higher standard applies in all cases under section 523(a).<sup>16</sup> Few juris-

<sup>16</sup> *In re Cheatham*, 44 B.R. 4 (Bankr. N.D. Ala. 1984) (§ 523(a)(2)); *In re Hefner*, 69 B.R. 257 (Bankr. N.D. Ala. 1986) (all § 523(a) actions); *In re Morgan*, 106 B.R. 573 (Bankr. E.D. Ark. 1989) (§ 523(a)(4) case, but states that all § 523(a) is clear and convincing); *In re Kissinger*, 106 B.R. 180 (Bankr. E.D. Ark. 1989) (§ 523(a)(2)(A)); *In re Drayman*, 77 B.R. 773 (Bankr. C.D. Cal. 1987) (§ 523(a)(2)); *In re Tilbury*, 74 B.R. 73 (Bankr. 9th Cir. 1987), *aff'd*, 851 F.2d 361 (9th Cir. 1988) (§ 523(a) generally when relating to fraud); *In re Buck*, 75 B.R. 417 (Bankr. N.D. Cal. 1987); *In re McClure*, 70 B.R. 955 (Bankr. S.D. Cal. 1987) (§ 523(a)(2)(A)); *In re Perea*, 89 B.R. 128 (Bankr. D. Colo. 1988) (§ 523(a) cases generally); *In re Mills*, 73 B.R. 168 (Bankr. D. Colo. 1986); *In re*

dictions unequivocally have applied the preponderance

*Perez*, 94 B.R. 765 (Bankr. M.D. Fla. 1988) (§ 523 generally); *In re Klag*, 112 B.R. 456 (Bankr. M.D. Fla. 1990) (§ 523(a)(2)(A)); *In re Stivers*, 84 B.R. 852 (Bankr. S.D. Fla. 1988) (§ 523(a)(2)(A)); *In re Picou*, 81 B.R. 152 (Bankr. S.D. Fla. 1988) (§ 523 generally); *In re Ayers*, 83 B.R. 83 (Bankr. M.D. Ga. 1988) (all § 523 actions); *In re Fontana*, 92 B.R. 559 (Bankr. M.D. Ga. 1988) (§ 523(a) generally); *In re Thomas*, 54 B.R. 287 (Bankr. D. Haw. 1985) (§ 523(a)(2)(A)); *In re Bonnet*, 73 B.R. 715 (C.D. Ill. 1987), *rev'd on other grounds*, 895 F.2d 1155 (7th Cir. 1989) (§ 523(a) generally); *In re Pochel*, 64 B.R. 82 (Bankr. C.D. Ill. 1986) (§ 523(a)(2)(A)); *In re Williams*, 85 B.R. 434 (Bankr. N.D. Ill. 1988) (§ 523(a)(2)); *In re Reitz*, 69 B.R. 192 (Bankr. N.D. Ill. 1986) (prior state court judgment on fraud); *In re Fitzgerald*, 109 B.R. 893 (Bankr. N.D. Ind. 1989) (§ 523(a)(2)(A)); *In re Gallagher*, 72 B.R. 830 (Bankr. N.D. Ind. 1987) (§ 523(a) generally); *In re Howard*, 73 B.R. 694 (Bankr. N.D. Ind. 1987) (§ 523(a)(2)); *In re Bonafas*, 41 B.R. 74 (Bankr. N.D. Iowa 1984) (§ 523(a)(2)(A)); *In re Smith*, 54 B.R. 299 (Bankr. S.D. Iowa 1985) (§ 523(a)(2)(C), but standard applies to § 523(a) generally); *In re Sayler*, 68 B.R. 111 (Bankr. D. Kan. 1986), *rev'd and remanded on other grounds*, 98 B.R. 536 (D. Kan. 1987) (§ 523(a)(2)(A)); *In re Roeder*, 61 B.R. 179 (Bankr. W.D. Ky. 1986) (§ 523(a)(2)); *In re Aldrich*, 16 B.R. 825 (Bankr. W.D. Ky. 1982); *but see In re Carr*, 49 B.R. 208 (Bankr. W.D. Ky. 1985); *In re Lamb*, 28 B.R. 462 (Bankr. W.D. La. 1983) (§ 523(a)(2)(A)); *In re Lyon*, 8 B.R. 152 (Bankr. D. Mo. 1981) (§ 523(a)(2)); *In re King*, 96 B.R. 413 (Bankr. D. Mass. 1989) (§ 523(a)(2)(B)); *In re Conley*, 78 B.R. 3 (Bankr. D. Mass. 1987) (§ 523(a)(2)(A)); *In re D'Annolfo*, 54 B.R. 887 (Bankr. D. Mass. 1985) (§ 523(a)(2)); *but see In re Daboul*, 85 B.R. 197 (Bankr. D. Mass. 1988) (preponderance with prior jury verdict on fraud under § 523(a)(2)); *In re Wellever*, 103 B.R. 856 (Bankr. W.D. Mich. 1989) (§ 523(a)(2), but preponderance for all else); *In re Hames*, 53 B.R. 868 (Bankr. D. Minn. 1985) (§ 523(a)(2)(A)); *In re Eberle*, 61 B.R. 638 (Bankr. D. Minn. 1985) (all § 523(a) actions); *Schwartz v. Renville Farmers Co-op Credit Union*, 44 B.R. 266 (Bankr. D. Minn. 1984) (§ 523(a)(2)(A)); *In re Self*, 51 B.R. 686 (Bankr. D. Miss. 1985) (§ 523(a)(2)); *In re Pyles*, 38 B.R. 92 (Bankr. W.D. Mo. 1984) (§ 523(a)(2)); *In re Canon*, 43 B.R. 733 (Bankr. W.D. Mo. 1984) (state court default judgment on fraud); *In re Sullivan*, 111 B.R. 317 (Bankr. D. Mont. 1990) (§ 523(a)(2)); *In re Riso*, 74 B.R. 750 (Bankr. D.N.H. 1987) (§ 727 case, but applies § 523(a) standard); *In re McIntyre*, 64 B.R. 27 (D.N.H. 1986) (§ 523(a)(2)); *In re Cook*, 21 B.R. 112 (Bankr. D.N.M. 1982) (§ 523(a)(2)(B), prior state court judgment); *In re Billings*, 94 B.R. 803 (Bankr. E.D.N.Y. 1989) (§ 523(a)(2)(A), prior default judgment in non-bankruptcy action on fraud); *In re Newmark*, 20 B.R. 842 (Bankr. E.D.N.Y. 1982) (§ 523 generally); *but see In re Baita*, 12 B.R. 813 (Bankr. E.D.N.Y. 1981) (§ 523(a)(2)(B), preponderance standard); *In re Verdon*, 95 B.R. 877 (Bankr. N.D.N.Y. 1989) (§ 523(a)(2)(A)); *In re Bossard*, 74 B.R. 730 (Bankr. N.D.N.Y. 1987) (all § 523 actions); *In re Schwartz*, 45 B.R. 354 (Bankr. S.D.N.Y.

standard.<sup>17</sup>

Petitioners and amici decry the inconsistency they claim will result if different burdens of proof are applied to different

1985) (§ 523(a)(2)(A)); *In re Gans*, 75 B.R. 474 (Bankr. S.D.N.Y. 1987) (§ 523(a)(2)(A)); *In re Jenkins*, 61 B.R. 30 (Bankr. D.N.D. 1986) (§ 523(a)(2)); *In re Burke*, 83 B.R. 716 (Bankr. D.N.D. 1988) (§ 523 generally); *In re Lang*, 108 B.R. 586 (Bankr. N.D. Ohio 1989) (§ 523(a)(2)(A)); *In re Constantino*, 72 B.R. 231 (Bankr. N.D. Ohio 1987) (§ 523(a)(2)); *In re Ritzer*, 105 B.R. 424 (Bankr. S.D. Ohio 1989) (§ 523(a)(2)(A)); *In re Browning*, 31 B.R. 995 (Bankr. S.D. Ohio 1983) (§ 523(a)(2)(A)); *In re Eversole*, 110 B.R. 318 (Bankr. S.D. Ohio 1990) (§ 523(a)(2)); *In re Lowther*, 32 B.R. 638 (Bankr. W.D. Okla. 1983) (§ 523(a)(2)(A)); *In re Farley*, 15 B.R. 11 (Bankr. D. Or. 1981) (§ 523(a)(2)(A), prior state court jury verdict against debtor on fraud); *United States v. Stelweck*, 108 B.R. 488 (Bankr. E.D. Pa. 1989) (§ 523(a)(2), follows majority); *In re Garcia*, 88 B.R. 695 (Bankr. E.D. Pa. 1988) (clear and convincing for § 523(a)(2) and preponderance for all others); *In re James*, 94 B.R. 350 (Bankr. E.D. Pa. 1988) (clear and convincing for § 523(a)(2)(A)); *In re O'Karma*, 46 B.R. 422 (M.D. Pa. 1984) (§ 523(a)(2)(B)); *In re Ward*, 88 B.R. 727 (Bankr. W.D. Pa. 1988) (§ 523(a)(2)); *In re Liptak*, 89 B.R. 3 (Bankr. W.D. Pa. 1988) (§ 523(a)(2)(B)); *In re Walker*, 7 B.R. 216 (Bankr. D.R.I. 1980) (§ 35(a)(2), predecessor of § 523(a)(2)); *In re Marks*, 40 B.R. 614 (Bankr. D.S.C. 1984) (§ 523(a)(2)(A)); *In re Adelman*, 90 B.R. 1012 (Bankr. D.S.D. 1988) (§ 523(a)(2)(A)); *In re White*, 106 B.R. 501 (Bankr. E.D. Tenn. 1989) (§ 523(a)(2)(A)); *In re Ashley*, 5 B.R. 262 (Bankr. E.D. Tenn. 1980) (§ 523(a)(2)); *In re Church*, 69 B.R. 425 (Bankr. N.D. Tex. 1987) (all § 523(a) actions); *In re Iverson*, 66 B.R. 219 (Bankr. D. Utah 1986) (§ 523(a)(2)(B)); *In re Huff*, 1 B.R. 354 (Bankr. D. Utah 1979) (§ 17(a)(2), predecessor to § 523(a)(2)); *In re Zack*, 99 B.R. 717 (Bankr. E.D. Va. 1989) (clear and convincing for § 523(a) and preponderance for all else); *In re Knott*, 32 B.R. 252 (Bankr. E.D. Va. 1983) (§ 523(a) generally); but see *In re Basham*, 106 B.R. 453 (Bankr. E.D. Va. 1989); *In re Barrup*, 37 B.R. 697 (Bankr. D. Vt. 1983), *reh'g denied*, 53 B.R. 215 (Bankr. D. Vt. 1985) (§ 523 generally); *In re Kaufmann*, 57 B.R. 644 (Bankr. E.D. Wis. 1986) (§ 523(a)(2)(A)); *In re Brink*, 30 B.R. 28 (Bankr. W.D. Wis. 1983) (§ 523(a)(2), false representation); *In re Trewyn*, 12 B.R. 543 (Bankr. W.D. Wis. 1981) (§ 523(a)(2)).

<sup>17</sup> *In re Ayala*, 107 B.R. 271 (Bankr. E.D. Cal. 1989) (§ 727 case, but would apply to § 523); *In re Stowell*, 102 B.R. 589 (Bankr. W.D. Tex. 1989), *modified in part, vacated in part*, 113 B.R. 322 (Bankr. W.D. Tex. 1990); *In re Showalter*, 86 B.R. 877 (Bankr. W.D. Va. 1988).

types of nondischargeable debts under section 523.<sup>18</sup> In fact, these differences always have existed and certainly prevailed at the time of the adoption of the Code. Moreover, nothing in the legislative history or any other legal authority suggests that the same burden or proof must apply to all claims under section 523(a).<sup>19</sup> In fact, the Third Circuit has held that:

[B]ecause Section 523 covers so many disparate circumstances, we doubt that Congress, without so stipulating, expected bankruptcy courts to apply a single standard of proof in all instances where a creditor asks for a declaration of nondischargeability. The suggestion, for example, that Congress intended the courts to require of spouses alleging a failure to pay child support the same kind of clear and convincing evidence universally required of creditors claiming fraud strikes us as farfetched.

*In re Braen*, 900 F.2d at 625.

<sup>18</sup> Under section 523 the following types of debts are nondischargeable: (1) taxes or custom duties; (2) money or property obtained by false pretenses, a false representation or actual fraud; (3) claims that were not timely filed; (4) fraud while acting in a fiduciary capacity, embezzlement or larceny; (5) alimony, maintenance or child support payments; (6) willful and malicious injury to the debtor; (7) fines, penalties or forfeitures to governmental units; (8) educational loans; and (9) judgments or consent decrees against a debtor resulting from the operation of a motor vehicle while legally intoxicated. 11 U.S.C. 523(a) (1988).

<sup>19</sup> To the contrary, at the time of the 1970 amendments to the Bankruptcy Code, Congress explicitly recognized that different types of activities had been grouped together as grounds to except a debt from discharge. The Explanatory Memorandum to accompany the Bill amending § 17 of the Bankruptcy Act states:

Section 14 of the Bankruptcy Act sets forth the statutory and only grounds upon which a discharge may be denied. With the exception of the grounds specified in clauses (5) and (8), all such grounds have their foundation in some form and degree of dishonesty or lack of cooperation on the part of the bankrupt. On the other hand, the grounds listed in clauses (5) and (8) are entirely distinct from such type of activity and, in fact, are such that some conflict of application and interpretation has arisen among the Courts.

Act of October 19, 1970, Pub. L. No. 91-467, 1970 U.S. Code Cong. & Admin. News (84 Stat. 990) 1156, 4161 (Explanatory Memorandum to Accompany Bill).

As noted by amici, some federal statutes which authorize suit by the United States specify that the government may prove its case by a mere preponderance of the evidence. However, those statutes, like the securities laws, are not "coextensive with common-law doctrines of fraud." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 388-89 (1983). The *Huddleston* Court found that Congress intended the securities industry to conform to a higher standard of conduct. Therefore, a lesser standard of proof was consistent with "an important purpose of the federal securities statutes . . . to rectify perceived deficiencies in the available common-law protections . . . ." *Id.* at 389. Accordingly, the Court rejected application of the common law requirement of clear and convincing evidence in actions under section 10(b) of the 1934 Securities Exchange Act. *Id.* at 388.

One of the statutes cited by amici, the False Claims Act, 31 U.S.C. §§ 3729-3731 (1982), was amended in 1986 to provide that actions thereunder be proved by a preponderance of the evidence. False Claims Amendment Act of 1986, Pub. L. 99-562, 100 Stat. 3158 (codified at 31 U.S.C. § 3731(c)). Certainly, Congress in 1986 must be deemed to have known the general rule that proof of fraud is by clear and convincing evidence. In fact, the legislative history reveals that Congress analogized this statute to the securities laws and favorably relied on this Court's decision in *Huddleston* in enacting 31 U.S.C. § 3731(c). S. Rep. No. 99-345, 99th Cong., 2d Sess. 31, reprinted in 1986 U.S. Code Cong. & Admin. News 5266, 5296. The same can be said of the enactment in August 1989 of 12 U.S.C. § 1833a(e) of the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-1833e (1950), providing for recovery by the Attorney General by a preponderance of the evidence. Like the securities laws, these various statutes are not coextensive with common law doctrines of fraud. These laws presumably were enacted to rectify perceived deficiencies in the available common-law protections and to establish higher standards of conduct for certain activities.

Amici also bemoan the unfair burden on the government if fraud must be proved by clear and convincing evidence in section 523(a)(2) proceedings. If such a burden exists, it can be alleviated simply by Congressional amendment to the Bankruptcy Code specifying the preponderance standard, as Congress has done in other federal statutes.

By affirming the judgment of the Eighth Circuit in this case, the Court simply will endorse the practice of every Court of Appeals and virtually every bankruptcy court that has addressed the issue. A decision in Respondent's favor will not open the floodgates to "relitigation," and it will not transform the bankruptcy courts into a shelter for wrongdoers. If there were any legitimate basis for that fear, the catastrophic results forecast by amici would have appeared long ago.

#### B. The "Fresh Start" Doctrine Compels Application of the Clear and Convincing Evidence Standard in Section 523(a)(2) Proceedings

The clear and convincing standard is consistent with the fresh start policy of the Bankruptcy Code. The bankruptcy discharge "represents an independent . . . public policy in favor of extricating an insolvent debtor from what would otherwise be a financial impasse." *United States v. Kras*, 409 U.S. 434, 447 (1973) (quoting J. MacLachlan, *Bankruptcy* 88 (1956)). The centerpiece of the 1898 Bankruptcy Act was the ability to obtain a discharge of one's debts. National Bankruptcy Act, ch. 541, § 2, 30 Stat. 545 (1898) (current version at 11 U.S.C. § 523 (1988)). The bankruptcy discharge—the means by which the "fresh start" doctrine is effectuated—is of sufficient importance that Congress has provided procedural safeguards against waiving the discharge. 11 U.S.C. § 524(c),(d) (1988).

The primary purpose of the 1898 Act was noted by the Court as early as 1915 in *Williams v. United States Fidelity & Guaranty Co.*, 236 U.S. 549 (1915): (1) to secure an equitable distribution of the debtor's assets among his creditors in partial payment of his debts; and (2) to release the debtor from the

burden of his obligations so that he may be given a new economic start in life. *Id.* at 554-55.

This Court later declared that: "One of the primary purposes of the bankruptcy act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'" *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (quoting *Williams*, 236 U.S. at 554-55). The fresh start provides the bankrupt with "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." *Id.*

The 1898 Act mandated a discharge unless the debtor was found to have committed one or more wrongful acts enumerated in section 14c rendering the bankrupt unworthy of being released from his or her obligations. The Act also provided for the exception of certain individual debts from discharge, including liabilities for obtaining money or property by false pretenses or false representations. 3 Liking, R. Babitt, A. Herzog & R. Levin, *Collier on Bankruptcy* ¶ 523.01 (15th ed. 1990). The Court has mandated that exceptions to discharge be strictly construed. *Gleason v. Thaw*, 236 U.S. 558, 562 (1915); see also 3 L. King, R. Babbitt, A. Herzog & R. Levin, *Collier on Bankruptcy* ¶ 523.05 n.3 (15th ed. 1990) ("Since the exceptions to dischargeability substantially frustrate the fresh start objective of the Code and the rehabilitative goal of the discharge provisions, they are to be strictly construed against an objecting creditor and in favor of the debtor's right to discharge of debts") (citations omitted).

In 1970, Congress amended the Bankruptcy Act to grant bankruptcy courts exclusive jurisdiction to resolve questions of dischargeability. *Brown v. Felsen*, 442 U.S. 127, 135-36 (1979). Sections 2a(12) and 38(4) were amended to give bankruptcy courts and referees additional jurisdiction to determine dischargeability of debts. Act of October 19, 1970, Pub. L. No. 91-467, 1970 U.S. Code Cong. & Admin. News (84 Stat. 990) 1156, 4161 (Explanatory Memorandum To Accompany Bill). The major purpose of the 1970 Amendments was "to effectuate,

more fully, the discharge in bankruptcy by rendering it less subject to abuse by harassing creditors." H.R. Rep. No. 1502, 91st Cong., 2d Sess. 1, reprinted in 1970 U.S. Code Cong. & Admin. News 4156, 4156. This concept of "exclusive jurisdiction" is carried forward in the 1978 Act in 11 U.S.C. § 523(c) and implements the Constitutional mandate that Congress establish "uniform laws on the subject of Bankruptcy throughout the United States." U.S. Const., art. I, § 8, cl. 4. See *In re Rudd*, 104 B.R. 8, 13 (Bankr. N.D. Ind. 1987).

The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978), was enacted to modernize and improve the efficiency and fairness of the bankruptcy process. See generally H. R. Rep. No. 595, 95th Cong., 1st Sess. 1, reprinted in 1978 U.S. Code Cong. & Admin. News 5963; S. Rep. No. 989, 95th Cong., 2d Sess. 1, reprinted in 1978 U.S. Code Cong. & Admin. News 5787. The 1978 Act also intended to carry forward the "fresh start" policy. S. Rep. No. 989 at 6. The basic discharge provisions were not changed.

The 1978 Act reflects Congress' continuing commitment to protect the discharge and promote the debtor's opportunity for a fresh start in life. Congress included section 523(d) specifically to protect debtors and to preserve the integrity of the fresh start doctrine. This new section permits the debtor to recover costs and attorneys fees if the court finds that a creditor, lacking good faith, challenges dischargeability in the hope of extracting a settlement with the debtor. "Such practices impair the debtor's fresh start and are contrary to the spirit of the bankruptcy laws." S. Rep. No. 989 at 80.

Also new in the 1978 Bankruptcy Reform Act was section 523(a)(2)(B). This section now requires that creditors who attempt to except a debt from discharge based upon a false financial statement establish that they reasonably relied upon the statement. S. Rep. No. 989 at 78 (emphasis added).

The "fresh start" policy permeates the Bankruptcy Code and is an important factor in construing its various provisions, including discharge. See, e.g., *In re McNeely*, 82 B.R. 628, 632 (Bankr. S.D. Ga. 1987) (Congress' purpose in enacting section

525 was to enforce the fresh start doctrine); *In re Klein*, 64 B.R. 372 (Bankr. E.D.N.Y. 1986) (denying motion by creditor to extend time to file a complaint objecting to discharge); *In re Neiheisel*, 32 B.R. 146 (Bankr. D. Utah 1983) (the fresh start doctrine is effectuated through the section 522 exemptions);<sup>20</sup> *In re Shamblin*, 18 B.R. 800, 802 (Bankr. S.D. Ohio 1982) (section 525 of the Bankruptcy Code was intended to codify the fresh start doctrine). All of these decisions are consistent with this Court's pronouncement that "[t]he various provisions of the bankruptcy act were adopted in the light of [the fresh start policy] and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act." *Local Loan Co.*, 292 U.S. at 245.

A finding of nondischargeability is of crucial private and public importance. The values and interests at stake in dischargeability proceedings are not limited to the mere loss of money, and such proceedings are not the "typical civil case involving a monetary dispute between private parties" where "society has a minimal concern with the outcome . . . ." *Addington v. Texas*, 441 U.S. 418, 423 (1979). Because of the fresh start doctrine, more is at stake in a section 523 proceeding than "the general run of issues in civil cases" where the preponderance standard is appropriate. E. Cleary, *McCormick on Evidence* § 340 (3d ed. 1984). The fresh start policy militates in favor of application of a clear and convincing standard of proof in section 523(a)(2) proceedings.

#### C. Interpretation of Other Provisions of the Bankruptcy Code Is Consistent With Application of the Clear and Convincing Standard in Section 523(a)(2) Proceedings

In interpreting the Bankruptcy Code, courts "must not be guided by a single sentence or member of a sentence, but look

<sup>20</sup> *Neiheisel* undertakes an exhaustive analysis and review of the fresh start policy and the legislative history surrounding the "fresh start". *In re Neiheisel*, 32 B.R. 146, 157-62 (Bankr. D. Utah 1983).

to the provisions of the whole law, and to its object and policy." *Kelly v. Robinson*, 479 U.S. 36, 43 (1986). See also *United Savings Ass'n v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988) ("A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme . . . because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law."). Moreover, "[t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midatlantic Nat'l Bank v. New Jersey Dep't of Env'tl. Protection*, 474 U.S. 494, 501 (1986) (citation omitted). There is no legislative history suggesting that Congress intended a lesser standard to prove fraud in a section 523(a)(2) discharge case than was traditionally required to prove fraud in civil cases at the time of the Code's adoption.

A finding of fraud is central to the fraudulent transfer provision of the Bankruptcy Code, 11 U.S.C. § 548(a)(1), which provides:

- (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
  - (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted;

11 U.S.C. § 548(a)(1) (1988) (emphasis added). In litigation under this section, bankruptcy courts consistently have applied the clear and convincing evidence standard. See, e.g., *In re Willson Dairy Co.*, 30 B.R. 67, 70 (Bankr. S.D. Ohio 1981) ("As is true of other causes of action for fraud under the Bankruptcy Code, § 548(a)(1) requires a party to prove actual

fraud by clear and convincing evidence"); *Phillips v. Wier*, 328 F.2d 368, 371 (5th Cir. 1964). See generally 4 L. King, M. Cook, R. D'Agostino & K. Klee, *Collier On Bankruptcy* ¶ 548.10 n.1 (15th ed. 1990).

A finding of fraud also is one of the grounds for appointment of a trustee in a Chapter 11 case. Section 1104 of the Code provides:

(a) At any time after the commencement of the case but before confirmation of a plan . . . the court shall order the appointment of a trustee—

(1) for cause, including *fraud*, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management . . . .

11 U.S.C. § 1104(a)(1) (1988) (emphasis added). The few cases that have addressed the burden of proof under section 1104, as well as the leading treatise, agree that clear and convincing evidence must be presented to justify the appointment of a trustee. See, e.g., *In re St. Louis Globe-Democrat, Inc.*, 63 B.R. 131 (Bankr. E.D. Mo. 1985); 5 L. King, C. Cyr, K. Klee, H. Minkel and W. Taggart, *Collier On Bankruptcy* ¶ 1104.01[7][b] (15th ed. 1990).

Amici point to the legislative history of 11 U.S.C. § 727 as suggesting that Congress intended the preponderance standard to apply under section 523(a). Section 727(a)(4) describes certain fraudulent conduct that will preclude a debtor's discharge in its entirety, including the making of a false oath or account, a false claim, the giving or receiving of money for acting or forbearing to act, or withholding of information. 11 U.S.C. § 727(a)(4) (1988). The legislative history cited by amici is found in certain House and Senate Reports referencing section 727(a)(4), and states in part: "[This] ground for denial of discharge is the commission of a bankruptcy crime, though the standard of proof is preponderance of the evidence rather than proof beyond a reasonable doubt." H.R. Rep. No. 595 at 384; S. Rep. No. 989 at 98.

Amici cite no case where the preponderance standard actually has been applied to section 727(a)(4) proceedings, and none holding that the legislative history of section 727(a)(4) has any bearing on the burden of proof requirements under section 523(a)(2). In fact, virtually every court attempting to interpret this sketchy legislative history has rejected it because of its inconsistency with all other applicable law. These courts instead have applied the clear and convincing standard. See, e.g., *In re Portner*, 109 B.R. 977, 980 (Bankr. D. Colo. 1989) ("this legislative history speaks not of setting a standard of proof, but instead, apprises us that a false oath case, although akin to perjury, need not be tested by the traditional criminal standard of proof beyond a reasonable doubt"); *In re Mayo*, 94 B.R. 315, 327 (Bankr. D. Vt. 1988) (reaching the same conclusion as *Portner* after finding that the legislative history is "sparse and . . . inconclusive"); *In re Garcia*, 88 B.R. 695, 701 (Bankr. E.D. Pa. 1988) (reaching the same conclusion as *Portner* and noting that it is "unclear whether Congress ever considered the intermediate standard traditional for fraud—i.e., clear and convincing evidence.").<sup>21</sup> It also is possible that Congress

<sup>21</sup> See also *In re Zell*, 108 B.R. 615, 623 (Bankr. S.D. Ohio 1989); *In re Erdman*, 96 B.R. 978, 984 (Bankr. D.N.D. 1988); *In re Dias*, 95 B.R. 419, 421 (Bankr. N.D. Tex. 1988); *In re Catignola*, 87 B.R. 702, 706 (Bankr. M.D. Fla. 1988); *In re Montgomery*, 86 B.R. 948, 955 (Bankr. N.D. Ind. 1988); *In re Johnson*, 82 B.R. 801, 804 (Bankr. E.D.N.C. 1988); *In re Booth*, 70 B.R. 391, 394 (Bankr. D. Colo. 1987); *In re Woerner*, 66 B.R. 964, 972 (Bankr. E.D. Pa. 1986); *In re Crawford*, 65 B.R. 378, 380 (Bankr. C.D. Cal. 1986); *In re Cohen*, 47 B.R. 871, 874 (Bankr. S.D. Fla. 1985); *In re Barrett*, 2 B.R. 296, 298 (Bankr. E.D. Pa. 1980). Many of these opinions cite to *Oriel v. Russell*, 278 U.S. 358 (1929), the subject matter of which would involve a section 727(a)(3) proceeding under the current Code. See, e.g., *In re Portner*, 109 B.R. at 983. The *Oriel* Court held that a contempt proceeding regarding a turnover order for books and records was a charge equivalent to fraud and must be established by clear and convincing evidence. *Oriel*, 278 U.S. at 362. One case that appears to hold that the preponderance of the evidence standard applies in section 727(a)(4) cases is *In re Parker*, 85 B.R. 384 (Bankr. E.D. Va. 1988). However, the same court, less than one year later, held that: "[F]or the purposes of fraudulent intent or fraud claims, the correct burden of proof is clear and convincing evidence. However, where fraud is not alleged, as in section 727(a)(3) claims, the correct burden of proof is a preponderance of the evidence." *In re Kim*, 97 B.R. 275, 281 (Bankr. E.D. Va. 1989).

merely considered the clear and convincing standard as a more demanding formulation of the preponderance standard applicable to certain issues. *Garcia*, 88 B.R. at 701.

Moreover, the conclusion that amici suggest is inconsistent with Bankruptcy Rule 4005 which "leaves to the courts" the evidentiary degree that an objecting creditor must sustain. 11 U.S.C. Rule 4005, Advisory Committee Note (1988). The inference suggested by amici also would be contrary to the uniform interpretation of 11 U.S.C. § 548(a)(1), which calls for "clear and convincing evidence" to prove a fraudulent transfer under the Code. *In re Bucci*, 97 B.R. 954, 957 (Bankr. N.D. Ill. 1989) (proof of "actual fraud" under either section 727(a)(2) or section 548(a)(1) must be by clear and convincing evidence).

Finally, the grounds for a complete denial of discharge under section 727 generally involve misconduct or fraud upon all creditors, or upon the court itself, within the confines of the bankruptcy proceeding. Congress may well have intended to prescribe a lower standard of proof under section 727(a)(4) than under section 523(a)(2) because the latter involves fraud with respect to the creation of a debt vis-a-vis one creditor only; it does not involve fraud upon the court or the bankruptcy process.

In light of the existing law regarding the burden of proof in fraud cases and the objectives and purposes of the Bankruptcy Code, the inconclusive legislative history found in the House and Senate Reports regarding section 727 must be rejected.

## II. A PRIOR CIVIL JUDGMENT OF FRAUD BASED UPON A PREPONDERANCE STANDARD OF PROOF DOES NOT COLLATERALLY ESTOP LITIGATION OF FRAUD ISSUES IN A SECTION 523(a)(2) PROCEEDING

In *Cromwell v. County of Sac.*, 94 U.S. 351 (1876), the Court explained the difference between res judicata (claim preclusion) and collateral estoppel (issue preclusion):

[T]here is a difference between the effect of a judgment as a bar or estoppel against the prosecution of a second action upon the same claim or demand, and its effect as

an estoppel in another action between the same parties upon a different claim or cause of action . . . .

[W]here the second action between the same parties is upon a different claim or demand, the judgment in the prior action operates as an estoppel only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered.

*Id.* at 352-53. Issue preclusion operates only with respect to individual legal and factual issues, not claims or causes of action. *Montana v. United States*, 440 U.S. 147, 153 (1979).

This Court has rejected application of res judicata in bankruptcy discharge proceedings. *Brown v. Felsen*, 442 U.S. 127 (1979). However, the Court did not prescribe a specific rule for the application of collateral estoppel:

If, in the course of adjudicating a state-law question, a state court should determine factual issues using standards identical to those of § 17 [of the 1898 Bankruptcy Act], then collateral estoppel, *in the absence of countervailing statutory policy*, would bar relitigation of those issues in the bankruptcy court.

*Id.* at 139 n.10 (emphasis added).

The courts and commentators appear to be split on the issue of whether collateral estoppel should apply in subsequent bankruptcy discharge actions. See *Spillman v. Harley*, 656 F.2d 224, 227-28 (6th Cir. 1981); *Carey Lumber Co. v. Bell*, 615 F.2d 370, 377-78 (5th Cir. 1980). *In re Ross*, 602 F.2d 604, 607-08 (3d Cir. 1979); *In re Black*, 18 B.R. 534 (Bankr. D.N.M. 1982); 3 L. King, R. Babitt, A. Herzog & R. Levin, *Collier on Bankruptcy* ¶ 523.11 (15th ed 1990); Ferriell, *The Preclusive Effect of State Court Decisions in Bankruptcy* (Second Installment), 59 Am. Bankr. L.J. 55 (1985); Ferriell, *The Preclusive Effect of State Court Decisions in Bankruptcy* (First installment), 58 Am. Bankr. L.J. 349 (1984).

Prior to the Court's opinion in *Brown v. Felsen*, the Ninth Circuit took a different approach in *In re Houtman*, 568 F.2d 651, 655 (9th Cir. 1978). The court held that a prior state court judgment has no collateral estoppel effect in a subsequent bank-

ruptcy court proceeding, but that it can establish a prima facie case of nondischargeability.

In light of (1) the exclusive jurisdiction given to bankruptcy courts to determine dischargeability under sections 523(a)(2) and (2) the all-encompassing fresh start policy of the Bankruptcy Code, Respondent urges that if collateral estoppel applies in section 523(a) bankruptcy discharge proceedings, that its scope be limited to ensure that it does not encroach upon the "countervailing statutory policy" of the fresh start doctrine.

If collateral estoppel applies in bankruptcy discharge proceedings, it applies only where each element set forth in the Restatement (Second) of Judgments § 27 is satisfied. Consistent with the Court's holdings in *Cromwell* and *Montana*, section 27 of the Restatement lists three prerequisites for collateral estoppel:

- (1) the issue actually was litigated in the first suit;
- (2) the issue must have been determined by a valid and final judgment; and
- (3) determination of the issue was essential to the prior judgment.

Restatement (Second) of Judgments § 27 (1982).

If, however, the burden of proof for the issue is substantially higher in the second action than in the first, there is no identity of issues and collateral estoppel does not apply. 18 C. Wright, A. Miller, & E. Cooper, *Federal Practice and Procedure* § 4422 at 209-12, 214-15 (1981 & Supp. 1990); Restatement (Second) of Judgments § 28(a)(4). Amici acknowledge this basic rule. Brief of amici curiae at 10 n.5. The drafters of the Restatement incorporated this concept into section 28(a):

Although an issue is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, relitigation of the issue in a subsequent action between the parties is not precluded [when]...[t]he party against whom preclusion is sought

had a significantly heavier burden of persuasion with respect to the issue in the initial action than in the subsequent action; the burden has shifted to his adversary; or the adversary has a significantly heavier burden than he had in the first action.

Restatement (Second) of Judgments § 28(a)(4) (1982). See also *id.*, comment f, illustration 11 (the clear and convincing standard is sufficiently heavier than the preponderance of the evidence standard to trigger section 28). The Ninth Circuit has recited the principle thus: "It is an elementary principle of issue preclusion that it may only be asserted where the burden of proof as to that issue is no greater than it was in the prior proceeding where the issue was decided." *United States v. Rylander*, 714 F.2d 996, 1002 (9th Cir. 1983), cert. denied, 467 U.S. 1209 (1984). See also *O'Shea v. Amoco Oil Co.*, 886 F.2d 584 (3d Cir. 1989).

In most cases involving different burdens of proof, the plaintiff in the prior action failed to carry a heavier burden than that required in the subsequent proceeding. Defendant then seeks to preclude plaintiff from reasserting the same claim in a subsequent action in which a lower standard of proof applied. The most common example is where the government fails to prove a criminal wrong beyond a reasonable doubt and the same defendant in a subsequent civil suit attempts to preclude relitigation of the issue on the basis of collateral estoppel. See, e.g., *One Lot Emerald Cut Stones v. United States*, 409 U.S. 232, 235 (1972) (an acquittal on criminal charges "does not constitute an adjudication on the preponderance-of-the-evidence burden applicable in civil proceedings"); *Bullock v. Pearson*, 768 F.2d 1191, 1193 (10th Cir. 1985), cert. denied, 474 U.S. 1086 (1986) (dicta stating that failure to establish fraud by clear and convincing evidence would not preclude relitigation of the issue if a lower standard of proof were applicable in a subsequent action); *Helvering v. Mitchell*, 303 U.S. 391, 405-06 (1938); *Murphy v. United States*, 272 U.S. 630, 632-33 (1926); *Stone v. United States*, 167 U.S. 178, 189 (1897).

If the failure to carry a higher standard, e.g., clear and convincing, in the first action does not constitute an adjudication on the lower standard, e.g., preponderance of the evidence, then it follows that carrying the issue by the preponderance standard does not constitute an adjudication under the clear and convincing standard.<sup>22</sup> Accordingly, application of collateral estoppel in the instant bankruptcy proceeding is improper, Restatement (Second) of Judgments § 28(a)(4) (1982); 18 C. Wright, A. Miller, & E. Cooper, *Federal Practice and Procedure* § 4422, at 214-15 (1981 & Supp. 1990), because Petitioners are required to prove fraud by clear and convincing evidence in a section 523(a)(2) discharge proceeding.

<sup>22</sup> In *United States v. Beery*, 678 F.2d 856 (10th Cir. 1982), cert. denied, 471 U.S. 1066 (1985), the court of appeals stated:

A defendant in a criminal case is not collaterally estopped from raising issues that were determined against him in a prior civil action. In view of the different degrees of proof in civil and criminal cases, the adjudication of a fact in a civil proceeding is not binding in a criminal case under principles of collateral estoppel.

*Id.* at 868 n.10 (citing *United States v. Konovsky*, 202 F.2d 721, 726-27 (7th Cir. 1953)). See also *Ferrel v. Pierce*, 785 F.2d 1372, 1378 n.2 (7th Cir. 1986) (heavier burden of proof precludes application of collateral estoppel); *Newport News Shipbuilding & Dry Dock Co. v. Director, Office of Workers' Compensation Programs*, 583 F.2d 1273, 1278 (4th Cir. 1978), cert. denied, 440 U.S. 915 (1979); *Young & Co. v. Shea*, 397 F.2d 185, 188-89 (5th Cir. 1968), cert. denied, 395 U.S. 920 (1969).

## CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

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